

(i) Costs for practitioner and therapy services which are provided on a contract or salary basis by the nursing facility are allowable costs.

(ii) The direct and indirect costs associated with noncompensable cost centers, such as a pharmacy or space rented or used by an independent practitioner, are not allowable costs.

(3) *Volunteer and donated services of individuals.*

(i) The actual costs that a nursing facility incurs when the nursing facility regularly uses the services of volunteer or religious organizations in positions that are normally held by full-time employees who provide resident care or assist with the operation of the nursing facility are allowable costs. The following conditions and limitations apply:

(A) The costs shall be limited to the fair market value of customary compensation of full-time personnel who perform similar services.

(B) The costs shall be based on regular working hours, excluding overtime.

(C) The actual costs for these services shall be supported by substantiating documentation.

(D) The costs will be reimbursed as part of the net operating costs.

(ii) The Department will recognize costs as allowable for nonpaid workers only if the following conditions are met:

(A) The nonpaid workers shall be members of an organization of nonpaid workers.

(B) Membership of a nonpaid worker in the organization shall be substantiated by adequate documentation in the files of the organization of nonpaid workers.

(C) A legally enforceable agreement between the nursing facility and the organization of nonpaid workers shall exist and establish the nursing facility's obligation to remunerate the organization for services rendered. If the nursing facility's legal obligation to pay the organization of nonpaid workers is nullified by an offsetting legal obligation by the

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organization of nonpaid workers to pay or make a contribution to the nursing facility of all or part of the salary liability, the amount paid or contributed by the organization of nonpaid workers is not an allowable cost.

(iii) A payment made by the organization of nonpaid workers to the nursing facility for the nonpaid workers' maintenance, perquisites or fringe benefits shall be used as an offset to the total of the cost actually incurred by the nursing facility.

(iv) Staff services relating to the use of volunteer workers are allowable costs.

(4) *Pastoral services.*

(i) Salary costs for pastoral services rendered directly to residents by professional staff employed by, or under contract with, the nursing facility are allowable costs.

(ii) Costs for a chaplaincy training program and pastoral housing are not allowable costs.

**§ 1187.56. Selected administrative cost policies.**

Policies for selected administrative costs are as follows:

(1) *Administrative allowance.*

(i) The allowable administrative costs incurred by a nursing facility to provide services are subject to the following limitation: the allowable administrative costs will be determined so that all other allowable costs, excluding capital costs, equal no less than 88% of the allowable net operating costs.

(ii) Home office cost allocations and management fees are subject to the following conditions and limitations:

(A) Home office cost allocations and management fees between related parties shall be reported without markup by the nursing facility.

(B) Costs which are not allowable, such as those related to nonworking officers or officers' life insurance, may not be included in home office allocations or management fees.

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(C) Documentation relating to home office and management costs shall be provided to the Department's auditors upon request.

(D) Home office allocations, including administratively allowable depreciation and interest costs shall be reported on the administrative line in the MA-11.

(iii) A nursing facility providing nursing, residential and other services shall allocate the total administrative cost to nursing, residential and other services on the basis of a percentage of these costs to the total net operating costs.

(2) *Other interest allowance.*

(i) Other interest is an allowable administrative cost if it is necessary and proper. To be considered allowable, necessary and proper, the interest expense shall be incurred and paid within 90 days of the close of the cost reporting period on a loan made to satisfy a financial need of the nursing facility and for a purpose related to resident care. Interest incurred to pay interest is nonallowable.

(ii) Other interest may not exceed that amount which a prudent borrower would pay as described in the Medicare Provider Reimbursement Manual (HCFA Pub. 15-1).

(iii) Other interest is allowable if paid on loans from the nursing facility's donor-restricted funds, the funded depreciation account or the nursing facility's qualified pension fund.

(iv) Monies borrowed for the purchase or redemption of capital stock will be considered a loan for investment purposes. The interest paid on these borrowed funds is a nonallowable cost. The use of funds by the nursing facility for the redemption of capital stock will be considered as an investment of available funds.

(3) *Investment Income.*

(i) Investment income is used to reduce allowable other interest unless the investment income is from one of the following:

(A) Gifts or grants of which the corpus and interest are restricted by the donor

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(B) Funded depreciation maintained in accordance with Federal regulations.

(C) The nursing facility's qualified pension fund, if the interest earned remains in the fund.

(D) Issuer specified designated capital bond funds or debt service reserve funds.

(ii) Investment income on funds found to be used for purposes other than their designated purpose or commingled with other funds will be used to reduce allowable administrative interest expense.

(4) *General administration expenses.*

(i) Salaries of the nursing facility's administrator, comptroller, purchasing agent, personnel director, pharmacy consultant and other persons performing general supervision or management duties are allowable as general administrative costs.

(ii) The salary or compensation costs of owners, operators or persons other than nursing facility employees shall be included as allowable costs only to the extent of their documented time and involvement in the required management of a nursing facility. These costs mean actual payment made during the cost reporting period on a current basis of salary or benefits for services rendered to the nursing facility.

(iii) If a person performs work customarily performed by different or several types of employees, the cost of the salary and other compensation allowable for the person shall be determined by the prorated customary salary and other compensation paid to employees for performing the same types of work. This cost is allowable only if adequate documentation verifying the cost is supplied by the nursing facility.

(iv) The allowable cost for a person performing necessary duties may not exceed the customary compensation and fringe benefits that an employee would normally receive while performing that work.

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(5) *Contracted management services.*

(i) In lieu of home office allocations or management fees, a nursing facility may contract with a nonrelated management service. The cost of this contract shall be shown as an administrative cost and may not be allocated among other cost centers.

(ii) Management services contracted with a related party shall be treated as home office allocations.

**§ 1187.57. Selected capital cost policies.**

The Department will establish a prospective facility-specific capital rate annually for each nursing facility. That rate will consist of three components: the fixed property component, the movable property component, and the real estate tax component.

(1) *Fixed property component.*

(i) The Department will base the nursing facility's fixed property component on the depreciated replacement cost of the nursing facility's fixed property and the associated financial yield rate.

(ii) On an annual basis, the Department will determine the depreciated replacement cost of each nursing facility's fixed property as of March 31, and will use that determination in setting the fixed property component for the rate year beginning on the following July 1.

(iii) The basis for the Department's determination of the depreciated replacement cost of the nursing facility's fixed property will be the most recent of the following appraisals, as modified by any limited appraisals, as of March 31:

(A) An initial appraisal.

(B) A reappraisal.

(C) An updated appraisal.

(iv) An initial appraisal of the nursing facility's fixed property will be conducted for any new nursing facility.

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(v) A reappraisal of the nursing facility's fixed property will be conducted at least every five years.

(vi) In situations where neither an initial appraisal nor a reappraisal has been done within the 12-month period preceding March 31, the depreciated replacement cost will be based upon an updated appraisal.

(vii) A limited appraisal will be conducted if the nursing facility notifies the Department that a limited appraisal is needed. For the results of a limited appraisal to be included in the determination of a nursing facility's fixed property component for the next rate year, a limited appraisal must be requested by the nursing facility by January 31 of the preceding rate year.

(viii) The depreciated replacement cost of the nursing facility's fixed property is subject to the cost per bed limitation in § 1187.112 (relating to cost per bed limitation adjustment) and, if applicable, the bed moratorium limitation in § 1187.113 (relating to capital component payment limitation).

(ix) The cost to purchase, construct, or renovate the fixed property of the nursing facility will not be a factor in determining the appraised depreciated replacement cost.

(x) When there is a change in nursing facility ownership, the new nursing facility owner is deemed to have the same appraised depreciated replacement cost as the former owner.

(xi) The appraisals of fixed property will be performed by qualified personnel from an independent appraisal firm under contract with the Department.

*(2) Movable property component*

(i) When the nursing facility's most recent audited MA-11 cost report available in the NIS database for rate setting is for a cost report period beginning prior to January 1, 2001, the Department will determine the movable property component of each nursing facility's capital rate as follows:

(A) The Department will base the nursing facility's movable property component on the depreciated replacement cost of the nursing facility's major and minor movable property and the associated financial yield rate.

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(B) On an annual basis, the Department will determine the depreciated replacement cost of each nursing facility's movable property as of March 31, and will use that determination in setting the movable property component for the rate year beginning on the following July 1.

(C) The Department will base the determination of the depreciated replacement cost of each nursing facility's movable property on a movable property appraisal.

(D) When there is a change in nursing facility ownership, the new nursing facility owner is deemed to have the same appraised depreciated replacement cost as the former owner.

(ii) When the nursing facility's most recent audited MA-11 cost report available in the NIS database for rate setting is for a cost report period beginning on or after January 1, 2001, the Department will determine the movable property component of each nursing facility's capital rate as follows:

(A) The Department will base the nursing facility's movable property component on the nursing facility's audited cost of major movable property, as set forth in that MA-11.

(B) Each nursing facility shall report the acquisition cost of all major movable property on the major movable property line of its MA-11 and shall report the cost of minor movable property and the cost of supplies as net operating costs in accordance with § 1187.51 (relating to scope) and instructions for the MA-11.

*(3) Real estate tax cost component.*

A nursing facility's real estate tax component will be based solely upon the audited cost of that nursing facility's 12-month real estate tax cost, as set forth on the most recent audited MA-11 cost report available in the NIS database.

**§ 1187.58. Costs of related parties.**

Costs applicable to services, movable property and supplies, furnished to the nursing facility by organizations related to the nursing facility by common ownership or control shall be included as an allowable cost of the nursing facility at the cost to the

related organization. This cost may not exceed the price of comparable services, movable property, or supplies that could be purchased elsewhere.

**§ 1187.59. Nonallowable costs.**

(a) *Nonallowable costs related to expenses and revenues.* The Department will not recognize as allowable costs the expenses or revenues of a nursing facility related to:

- (1) Nonworking officers' or owners' salaries.
- (2) Fundraising expenses for capital and replacement items exceeding 5% of the amount raised and, for operating expenses and cash flow, fundraising expenses exceeding 10% of the amount raised.
- (3) Free care or discounted services.
- (4) Parties and social activities not related to resident care.
- (5) Organizational memberships not necessary to resident care.
- (6) Personal telephone service.
- (7) Personal television service.
- (8) The direct and indirect costs related to nonallowable cost centers, including gift, flower and coffee shops, homes for administrators or pastors, convent areas and nurses' quarters, except as provided in § 1187.55(3) (relating to selected resident care and other resident related cost policies).
- (9) Vending machines.
- (10) Charitable contributions.
- (11) Employee and guest meals.
- (12) Pennsylvania Capital Stock and Franchise Tax.
- (13) Income Tax.
- (14) Ambulance costs.
- (15) Promotional advertising, including a yellow page listing larger than a minimum insert.



- (16) Late payment penalties.
- (17) Taxes based upon net income.
- (18) Officers' and directors' life insurance, including life insurance premiums necessary to obtain mortgages and other loans.
- (19) Bad debts or contractual adjustments.
- (20) Collection expenses associated with bad debts.
- (21) Losses on the sale of fixed and movable assets.
- (22) Remuneration of any kind for any purpose, including travel expenses for members of the Board of Directors.
- (23) Dry cleaning, mending or other specialty laundry services.
- (24) Depreciation on fixed or movable property, capital interest, amortization - capital costs and rental expense for fixed property.
- (25) Expenses or revenues not necessary to resident care.
- (26) Costs, including legal fees, accounting and administrative costs, travel costs and the costs of feasibility studies, attributable to the negotiation or settlement of the sale or purchase of a capital asset - by acquisition or merger - for which payment has previously been made under Title XVIII of the Social Security Act (42 U.S.C.A. §§ 1395 - 1395yy) if the sale or purchase was made on or after July 18, 1984.
- (27) Letter of credit costs.
- (28) Legal expenses related to an appeal or action challenging a payment determination under this chapter until a final adjudication is issued sustaining the nursing facility's appeal. If the nursing facility prevails on some but not all issues raised in the appeal or action, a percentage of the reasonable legal expenses is allowable based upon the proportion of additional reimbursement received to the total additional reimbursement sought on appeal.
- (29) Nonstandard or nonuniform fringe benefits.
- (30) Return on net equity and net worth.

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(b) *Nonallowable costs related to revenue producing items.* In determining the operating costs of a nursing facility, the Department will not allow costs related to:

- (1) The sale of laundry and linen service.
- (2) The sale of drugs to nonresidents.
- (3) The sale of medical and surgical supplies to nonresidents.
- (4) The sale of clinical records and abstracts.
- (5) The rental of quarters to employees and others.
- (6) The rental of space within the nursing facility.
- (7) The payments received from clinical specialists.
- (8) Discounts on purchases which include trade, quantity and time.
- (9) Rebates and refunds of expenses.

(c) *Income that reduces allowable costs.*

- (1) Except as provided in § 1187.56(3)(i) (relating to selected administrative cost policies), any form of investment income shall be used to reduce the allowable administrative interest expense.
- (2) Grants, gifts and income designated by the donor for specific operating expenses are used to reduce the allowable costs relating to the specific operating expense.
- (3) Recovery of insured loss shall be used to reduce the allowable costs relating to the insured loss.
- (4) Applicable revenue producing items, other than room and board, shall be used to reduce the related allowable costs.
- (5) Payments received under an exceptional DME grant reduce the allowable cost of the major movable property and related services and items in the cost centers where the costs were originally reported in the MA-11.

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